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No. 95-1232

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1995

GENERAL MOTORS CORPORATION,

Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,

Respondent.

On Writ of Certiorari to the Supreme Court of Ohio

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

WILLIAM PAUL RODGERS, JR.
GENERAL COUNSEL & *COUNSEL OF RECORD*

CHARLES D. GRAY
ASSISTANT GENERAL COUNSEL

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS
Post Office Box 684
Washington, D.C. 20044-0684
(202) 898-2200
Counsel for Amicus Curiae

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QUESTION PRESENTED

Whether the Commerce Clause or the Equal Protection Clause requires States to tax purchases from natural gas utilities and natural gas marketers in the same manner, when State-regulated utilities have unique duties and obligations under law that set them apart from non-regulated businesses.

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BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF *AMICUS CURIAE*

The National Association of Regulatory Utility Commissioners (NARUC) submits this brief as *amicus curiae* in support of Respondent due to the substantial harm reversal of the decision below could have upon the regulation of public utilities by its member State regulatory commissions. The NARUC files this brief with the written consents of the Petitioner General Motors Corp. (hereafter "General Motors") and the Respondent

Roger W. Tracy (hereafter "Ohio"), which have been filed separately with the Clerk.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. The Association has no corporate parents or subsidiaries. Recognized by the Congress as "the national organization of the State commissions", 47 U.S.C. § 410(c) (1971), the NARUC presents the collective interest of State commissions charged with regulating the rates and conditions of service for the intrastate operations of electric, natural gas and telephone utilities. The NARUC's member commissions are obligated under State law to ensure that the rates charged to retail consumers are just and reasonable. The NARUC's mission is to serve the public interest by seeking to improve the quality and effectiveness of public utility regulation in America. Both Congress and the Federal courts have long recognized that the NARUC is a proper party to represent the collective interest of State regulatory commissions.[1]

In the decision herein under review, the Supreme Court of Ohio affirmed a ruling of the State's Board of Tax Appeals upholding the State's sales and use tax structure as applied to

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[1] *See, for example, United States of America v. Southern Motor Carrier Rate Conference, et al.*, 467 F.Supp. 471 (N.D. Ga. 1979), *aff.* 672 F.2d 469 (5th Cir. Unit "B" 1982); *aff. en banc*, 702 F.2d 532 (5th Cir. Unit "B" 1983, *rev'd*, 471 U.S. 48 (1985). *See also, Indianapolis Power and Light Co. v. Interstate Commerce Commission*, 587 F.2d 1098 (7th Cir. 1982); *Washington Utilities and Transportation Commission v. FCC*, 513 F.2d 1142 (9th Cir. 1976).

sales of natural gas to Ohio consumers.[2] A critical question at issue in this case is whether the special status placed upon public utilities by State law and regulation -- i.e. the duties and obligations that State-issued utility status confers -- can withstand analysis under the Commerce Clause. Here, the issue involves the State of Ohio's decision to tax utilities selling natural gas at retail differently than other gas sellers not subject to the burdens and benefits of public utility status. However, a decision by this Court reversing the decision below and finding Ohio's disparate tax treatment unconstitutional could call into question other factors which set utilities apart from non-regulated businesses, such as the grant of the power of eminent domain or the system of exclusive franchising which lie at the heart of utility regulation.

The NARUC does not seek to defend State actions which genuinely discriminate against interstate commerce, nor do we endorse any particular scheme for the taxation of the goods and services that utility companies provide. However, as the representative of the State agencies which confer and supervise the unique status of "public utility," the NARUC has a vital interest in participating in this case to provide background on State regulation of businesses "affected with the public interest"

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[2] The opinion of the Supreme Court of Ohio is reported at 652 N.E.2d 188 and appears at pages 1a-5a of the Petition for Certiorari. The unreported order of the Board of Tax Appeals appears at 6a-19a of the Petition.

and to address the broader context within which this tax dispute resides.

SUMMARY OF ARGUMENT

As Ohio describes in its brief on the merits, this case turns on the distinction between the commercial activities of two very different types of businesses: on the one hand, State-regulated public utilities (such as communications common carriage; generation, transmission and distribution of electricity; and as here, local distribution and retail sales of natural gas), and on the other, non-regulated businesses seeking to provide some, but not all, traditional "utility-type" services. The State of Ohio taxes these two types of businesses differently, not because they happen to be providing services in competition in a particular inter or intrastate market, but because of their distinctly different regulatory status under Ohio law. Because the differences in taxation under consideration in this litigation are but one element in the broader tableau of the rights and obligations of utilities under State law, the NARUC submits that the State of Ohio has a rational basis for distinguishing between local gas distribution and non-regulated businesses operating within and without the State. Accordingly, the decision of the Supreme Court of Ohio should be affirmed.

ARGUMENT

THE STATES HAVE TRADITIONALLY AND LEGITIMATELY DISTINGUISHED BETWEEN UTILITY AND NON-UTILITY BUSINESSES

As Justice Brandeis remarked in dissent in 1929 concerning the special status of a public utility established under Oklahoma law:

> a franchise to operate a public utility is not like the general right to engage in a lawful business, part of the liberty of the citizen; . . . it is of the essence of a special privilege that the franchise may be granted or withheld at the pleasure of the State; . . . it may be granted to corporations only, thus excluding individuals; . . . the Federal Constitution imposes no limits upon the State's discretion in this respect.
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> *Frost v. Corporation Commission*, 278 U.S. 515, 534 (1929)

While *Frost* involved the issue of competition in the market for the services of cotton gins, Justice Brandeis' observation that States can and do provide disparate treatment to the public utility franchises they create remains a fundamental premise of State regulation of energy and communications companies. Indeed, as first upheld in *Munn v. Illinois*, 94 U.S. 113 (1877), the ability of States to single out private businesses that they find to be "affected by the public interest" and constitutionally regulate their prices and conditions of service is

one of the three main legal doctrines underpinning modern economic regulation.[3]

There are important reasons why States provide different treatment to franchised utilities. Most fundamentally, utilities exercise substantial market power (if not always monopoly power) in the provision of retail services deemed essential to the public. As this court has acknowledged, "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983). Indeed, it has been a critically important (but often overlooked) development in the economic history of this century that each of the fifty States has chosen to exercise its inherent police powers to construct the legal status of "public utility" for very large private sector businesses operating pervasively within their respective borders.[4] These businesses, which provide much of the Nation's heat,

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[3] State economic regulation as now understood would not be viable without this court's rulings in two other lines of cases: the "State action" doctrine which allows States to require private businesses to implement policies that would violate Federal antitrust laws if implemented alone, *see Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48 (1985); and the "end result" doctrine which allows economic regulators to use a range of regulatory tools and methodologies in establishing utility rates provided that the end-result of the rate-setting process is within the range of reasonableness, *see FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

[4] *See*, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, *Utility Regulatory Policy in the United States and Canada: Compilation 1994-1995* (1995) (hereafter NARUC COMPILATION) at 14-17.

light, communication and energy services, represent billions of dollars of capital invested by private shareholders in reliance on their status as State-defined utility companies. Until the very recent wave of privatization sweeping the globe, the United States had been virtually alone in its decisions, first, to permit (and indeed encourage) private-sector ownership of facilities providing such vital services, and second, to determine (and again encourage) that the regulation of the monopoly powers inhering in these businesses would be undertaken primarily through the police powers of the States recognized in *Arkansas Electric Cooperative, supra.*

As General Motors recounts in its brief on the merits, Federal and State policies governing the sale, transmission and distribution of natural gas have undergone substantial change in recent years, raising the question of whether the model of regulated utility monopoly can justify the distinction drawn by the court below.[5] In similar fashion, policies governing communications and electricity markets are also changing at both State and Federal levels - a process that this court has been quick

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[5] Pet Br. at 2-4, citing the Federal Energy Regulatory Commission's Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,402 (1985); and Order No. 636, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13,267, 13,269 (1992).

to grasp.[6] However, while these developments share a common pro-competitive theme, they clearly do not constitute the implementation of a global policy of "deregulation" intended to sweep aside the concept of the utility enshrined in State and Federal law. As this case illustrates, Ohio (along with virtually every other State) retains the utility model for the distribution of natural gas, notwithstanding the Federal policy of well-head price deregulation or the availability of open-access transmission and distribution services. Similarly, despite provisions in the recent Telecommunications Act which open the local telephone exchange to competition, State regulation of communications providers as a public utility was not abolished, but reformed. Whatever the effect of injecting the forces of competition into some aspect of the natural gas business (e.g. marketing) there will remain core utility-type functions (e.g. local gas distribution) that retain the market power/public service attributes which provide the States grounds to impose special regulatory and tax policies.[7] A related reason why utilities are treated differently

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[6] *See, Duquesne Light Co. v. Barasch*, 488 U.S. 299, 316 n. 10 (1989) (anticipating "[t]he emergent market for wholesale electric energy.") *See also* FERC Order No. 888, Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61 Fed. Reg. 21,540 (1996), and the TELECOMMUNICATIONS ACT OF 1996, Pub.L. 104-104, 110 Stat. 56 (1996).

[7] For a general discussion of the obligations State economic regulation imposes on public utilities, *see* PHILLIPS, *The Regulation of Public Utilities* (1984) at 106-7.

is their ability to use public rights of way through the power of eminent domain granted by both State and Federal law.[8]

Utilities also receive special treatment under both State and Federal laws which require them to perform certain social welfare functions not imposed on non-regulated businesses. For example, under State law, natural gas utilities may be required to provide services to low-income, elderly and infirm customers during the winter whether or not customer bill payments are current.[9] Similarly, utilities may be required to fund energy conservation programs (which serve to reduce their sales volumes), provide funding for research and development, support programs to reduce environmental impacts beyond levels otherwise required of non-regulated entities, and face restrictions

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[8] Virtually every State grants utilities the right to condemn private property through either an administrative proceeding before a State regulatory commission or a judicial proceeding in State court. NARUC COMPILATION, *supra*, at 144. Section 7(h) of the Natural Gas Act, 15 U.S.C. § 717f(h) (1976) provides interstate pipelines with similar rights.

[9] *See* NARUC COMPILATION, *supra*, at 468-9 describing special rules for disconnection of natural gas and electric service during cold weather. In 1978, Congress enacted section 303 of the Public Utility Regulatory Policies Act (PURPA) requiring State regulatory commissions to conduct proceedings to consider implementing cold-weather policies such as these for their natural gas distribution companies. In do doing, Congress too recognized the special status of gas distribution utilities, imposing this obligation only on natural gas utilities and not other types of gas sellers. Pub.L. 95-617, 92 Stat. 3117 (1978).

on their ability to advertise that non-regulated businesses are free to adopt or ignore.[10]

In light of these factors, it is hardly surprising that Ohio treats gas sales by regulated utilities differently for tax purposes than sales by either in-State or out-of-State marketing companies. In the words of Justice Brandeis in *Frost, supra*, "a franchise to operate a public utility is not like the general right to engage in a lawful business." Given the utility franchise obligation to provide affordable and reliable service to all customers at regulated prices and to implement a host of State and Federal environmental and social welfare policies, the special status of utilities continues to be a critical component of the Nation's economy, notwithstanding the industry restructuring activities now ongoing. While this case involves a system for the taxation of utility companies, a decision of this court which fails to recognize and preserve the regulatory status of utilities could erode the ability of States to exercise their police powers more broadly to regulate utilities in the public interest.

Given the disparate rights and obligations the State establishes for the utility companies it regulates, there is clearly

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[10] *See* NARUC COMPILATION at 562-3 (concerning extent of State commission implementation of conservation incentive programs for gas utilities), at 414-5 (concerning recovery of research and development and pollution abatement costs), and at 44 (concerning restrictions on recovery of advertising expenditures in utility rates). Under section 303 (b)(2) and (4) of PURPA, *supra*, Congress established a policy for State regulatory commissions to consider imposing such restrictions on advertising by gas utilities and funding conservation programs.

a rational basis for the distinctions Ohio has drawn. Accordingly, the decision of the Court below should be affirmed.

CONCLUSION

The judgment of the Supreme Court of Ohio should be affirmed.

Respectfully submitted,

WILLIAM PAUL RODGERS, JR.*
General Counsel & COUNSEL OF RECORD

CHARLES D. GRAY
Assistant General Counsel

National Association of Regulatory
Utility Commissioners
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044
(202) 898-2200

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